Prepared Statement of Leonard Holt
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Thank you Commissioner Shulman, Deputy Commissioner Ernst and Director Hawkins for the opportunity to participate in this Forum and to share our views regarding the regulation of federal income tax preparers. My name is Leonard Holt, and I am the Vice President, Business Development for CCH Small Firm Services (SFS). We publish two of the leading professional tax software products, ATX and TaxWise. There are over 45,000 tax preparation offices that use one of our products, representing close to 100,000 paid preparers. Nearly 60% of these professionals are CPAs, Enrolled Agents or attorneys, while the remainder have varying levels of formal training and/or workplace experience. In addition, TaxWise is the software product used at more than 10,000 VITA and AARP sites, the military JAG office and IRS walk in offices. Together these organizations represent approximately another 80,000 users.

Because of the wide diversity of training and knowledge among the nearly 200,000 individuals using our programs, we have extensive experience developing tax preparation software that can serve the needs not only of highly educated CPAs but also of seasonal tax preparers and even volunteers who assist millions of Americans with their tax returns. As a result, we are acutely aware of the problems that exist in our industry and the need to know more about who is assisting taxpayers in the vital task of preparing and filing their annual tax returns.

My comments today will focus on five different but related topics; preparer registration, preparer testing, tax related bank products, the role of tax software companies, and some suggestions of actions the Internal Revenue Service should consider to address some of these issues.

As a general statement, we believe that the time has come to register tax preparers, and to establish a process to ensure that preparers have the necessary competence to properly offer their services to the public. As is generally the case in such matters, it is in the details of implementation that problems may arise.

Preparer Registration

Given that paid professionals prepare over 60% of all U.S. Individual Income Tax Returns, it is vital that people offering these services be known to the Internal Revenue Service. It is also important that these preparers be identified in a manner that allows taxpayers to know they are dealing with a legitimate preparer, one who is known to and registered with the Internal Revenue Service. How that registration takes place is an essential part of the process. Software companies can and should play a major role in this process. The cost to the government of registering hundreds of thousands of preparers will be substantial. We suggest that software companies be IRS's partners in this regard. We would capture the information for preparers who use our software products and share that information with the Service in a format that would allow for uploading into a central data base. Furthermore, we believe registration should be at the preparer level, not at the

tax office level, because many tax preparation businesses have substantial staff turnover. It would be far more efficient, therefore, to decentralize the registration process and let software publishers and transmitters gather the data on individual users. That way, the IRS records would remain constantly current based on the actual activity around tax preparation, not on a once-a-year registration process.

Preparer Testing

In many ways, the issues around testing are similar to those around registration. We feel that all preparers should be tested, not just the office manager/owner. Once again, testing by the software publishers and transmitters would ensure that all preparers are tested before they begin work preparing tax returns and would permit tax preparation businesses to add employees during the tax season.

We also think that all preparers should be tested regardless of any professional certifications or associations memberships, and that no exceptions should be granted for preparers who complete any of the many tax courses currently available. Completing those courses should enable students to pass the IRS tests, but should not be accepted in lieu of a standardized test. Nor should we assume that because an individual holds a professional certification that he or she is necessarily qualified or trained to prepare a tax return.

We would suggest that any test be standardized and designed to establish competence to prepare a reasonably complicated Form 1040. More sophisticated 1040s along with business returns of all types are generally prepared by professionals who specialize in that type of practice. And the problems that have been discussed during these hearings have focused almost entirely on incompetence or fraud in the arena of fairly basic individual tax returns. We emphasize the need to set the bar at modest levels because of the demonstrated need of tens of millions of taxpayers for assistance with relatively uncomplicated individual returns. Setting the test standards too high risks a shortage of low- to moderate-cost professionals to assist in this task.

The content of the test should be developed by the Internal Revenue Service, and then presented and scored by a large number of pre-approved outlets, including tax software companies. In that manner, we could ensure that our customers are properly tested, and return the results of the tests to the centralized date base for updating. Once again, the testing and data gathering would be constant and based on actual activity in the field rather than on centralized, once-a-year efforts.

One final point in this regard. We have suggested for years that preparers who want to become enrolled agents be required to obtain an EFIN, and demonstrate that they Efile all, or nearly all, returns that qualify. It strikes us as strange that a preparer would hold themselves out as being tax experts when they do not use the most efficient, least costly, and least error prone medium to file their clients' returns.

Tax Related Bank Products

Much has been written and said about refund loans and transfers. I simply want to point out a few things about these programs which I believe have either been misstated, or at least misunderstood. Some consumer groups have alleged that bank products entice preparers to increase the size of refunds because the preparers receive incentives based upon the size of the refund loan. This is simply not true, and it has never been true. For the most part tax preparers receive no compensation related to refund loans. And in the few instances where they do, it is a minimal, fixed fee of about $5.00. Taxpayers seek out refund-related bank products because they are understandably eager to obtain the amount of their refund as quickly as possible or they wish to pay their tax preparation fees out of their refund or they do not have a bank account into which they can receive a direct deposit — or for all three reasons. Preparers offer bank products to serve those taxpayer needs. Many taxpayers do not have the ability to prepare their own tax returns, and many more are not interested in doing so. It is a task they view as unpleasant at best, and intimidating at worst. Lower income taxpayers know they are entitled to various credits, and need the services of tax professionals to properly claim those credits. Bank products are the solution for these taxpayers.

It is also important to look at the total fees charged to taxpayers who use a preparer and take a bank product. Some preparers who have lowered the costs of refund loans have raised their tax preparation fees to make up the lost revenue. In this instance, every taxpayer incurs some of the bank product costs, not just the taxpayers who take advantage of them.

The Role of Tax Software Companies

There have been suggestions that the IRS also regulate tax software as a way to somehow improve the quality of tax preparation. This is a very delicate issue that we advise the Service to approach very carefully. The evolution of computerized tax preparation and electronic filing of tax returns has had a massive and salutary impact on the entire tax system in the United States. It has enabled tens of millions of Americans to more quickly, easily and accurately prepare and file their tax returns. It has led to the creation of a large and well-accepted industry that now helps more than 60% of American taxpayers prepare and file their returns. And it has dramatically lowered the cost of tax collection by federal and state agencies, permitting the closing of several IRS service centers and the redirection of those resources to enforcement and compliance activities. Tax software is, in short, a rousing success story. There are inexpensive programs costing $100 or less and expensive programs that might cost $10,000 a year or more to obtain all the federal and state forms. There are tax packages integrated with accounting suites and other packages integrated with payroll products. The government should not involve itself in these issues. The competitive market place has and will continue to dictate both the design and cost of these software programs. This should be a free market issue, not one for government mandates. If the Service wants to perform some sort of testing over and above that currently done for Efiling, it will have to obtain a lot of subject matter expertise and devote a lot of resources to that end. We feel those resources could be

better applied elsewhere. It would be a mistake to make any changes in this finely tuned tax ecosystem without extreme due diligence.

The tax software industry is also highly competitive as publishers have developed different systems and user interfaces to suit their particular customer bases. Professional tax preparers can choose between interview-based, forms-based or hybrid designs. There are products that perform most of the calculations automatically and others that require users to perform more manual calculations using worksheets.

We also believe that any action on tax software should include online products. Online software has continued to gain public popularity, and we believe that trend will continue. However, the reports we have seen indicate that the rate of fraud in online returns was increasing much faster than in the professional market. That makes sense in that the anonymity of the filer is key. The overwhelming majority of paid professionals are honest and ethical and deter fraud in their role as the intermediary between taxpayers and the government.

Suggested IRS and Congressional Actions

One of the major problems for everyone in this business, both in government and in private industry is legislative changes that come late in the year—or even once the tax season has begun. I know, everyone has been saying that for years. But in the past couple of years it has gotten worse. Political and economic pressures have led to dramatic changes too late to be accurately programmed and tested in software, and too late to allow proper training of tax preparers and IRS Tax Assistors. We encourage everyone to ask their elected representatives to alter this trend. Any legislative change should not take effect for at least 12 months after enactment, and should allow time for the Internal Revenue Service and the industry to effectively prepare.

The cost of bank products is always a controversial topic. But competition always lowers costs, and that has begun to happen in bank products. But even with the competitive pressures lowering costs, more can be done. One of the major contributors to the cost of Refund Loans is loan loss—that is the refund loans that are not repaid because there is no refund or a less than expected refund issued on that return. In round numbers, the average refund loan amount is about $3600. Using a 1% loan loss as a basis, $36 of the fees charged for the loans do nothing but cover the costs of unpaid loans.

An additional suggestion we would like to propose is that the IRS should replace the debt indicator in electronically filed returns with a "positive pay" indicator. This would sharply drive down the costs of bank products, would allow preparers to provide better customer service, and would help protect confidential taxpayer information. Simply put, take a little longer to produce the acknowledgement, so that an indicator will or will not have a positive pay indicator. The industry does not need to know why a refund will or will not be paid, only that it will or will not be paid. This would solve many problems for the IRS and the industry and reduce costs for taxpayers.

Summation

To close, I want to reiterate that we strongly favor registering and testing anyone who assists taxpayers in preparing tax returns, and we appreciate it that the Service is studying this issue so carefully. This is a very important topic, and getting it right is more important than doing it quickly. We will help in any way we can.